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Transparency and Disclosure Requirements for Corporate Governance:

Report by the Ad Hoc Consultative Group of Experts on Corporate Governance Disclosures

Executive summary

At UNCTAD's 10th quadrennial conference (Bangkok, February 2000) Member States called on the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) to promote increased transparency and financial disclosure by encouraging the use of internationally recognized accounting and auditing standards and improved corporate governance. Since that time, a number of corporate failures have caused a significant loss in investor confidence, highlighting the fact that improvements in corporate governance are required in developed and developing countries alike.

This report contains the deliberations of the ad hoc consultative group of experts on corporate governance disclosure requirements. Reference is also made to relevant recommendations contained in various milestone reports and codes of corporate governance. The ad hoc group conducted informal consultations on best practices for disclosure requirements that developing countries and countries with economies in transition could implement to promote greater transparency and better disclosure and thereby increase the flow of foreign direct investment to their economies.

The deliberations of the consultative group covered such issues as financial disclosures in relation to corporate governance; disclosures of the objectives of enterprises; ownership and control structures; the role and functions of the board and board members; the background and qualifications of board members; performance evaluation mechanisms; compensation, succession plans, risk management and internal controls; auditor independence; and environmental and social stewardship. Disclosure issues regarding annual general meetings, voting, stockholder rights, timing and means of disclosure were also addressed.

This report is being presented for consideration and action by the 19th session of ISAR.

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INTRODUCTION

1. At its 10th quadrennial conference, which was held in Bangkok in February 2000, member States requested UNCTAD to "promote increased transparency and financial disclosure by encouraging the use of internationally recognized accounting, reporting and auditing standards and improved corporate governance". In response to the above request, the 17th session of the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) decided to review existing corporate governance practices and country, company and regional codes and principles. Accordingly, a review was conducted and was presented at the 18th session of ISAR, which took place in Geneva on 10–12 September 2001.

2. In concluding the 18th session and adopting the provisional agenda for the 19th session, the Group of Experts proposed to work on issues related to corporate governance. Discussions focused on how ISAR could contribute to the improvement of corporate governance practices in member States and on how it could assist developing countries and countries with economies in transition in identifying and implementing best corporate governance practices to achieve better transparency, financial disclosure and accountability. This was not the first time ISAR had taken up this issue. In 1989, at its seventh session, it agreed on disclosure by boards of directors. The current work revisits and expands that work.

3. Through informal consultations conducted in a two-day workshop on 13–14 September 2001 and e-mail and fax communications thereafter, agreement was reached to focus the work on disclosure requirements on corporate governance with a view to developing guidelines. Most experts justified this specific topic as one that is consistent with ISAR's mandate to promote better transparency and disclosure and which would add value to existing initiatives. During the discussions it was noted that:

- Transparency and disclosure have been recognized as the major elements of a sound corporate governance system by most codes and rating models of corporate governance;

- Recent events in financial markets reveal the need to implement these codes or translate them into practical action according to the particular business environment;

- Disclosure requirements on corporate governance although outlined as an important issue, have not yet been specifically and comprehensively addressed by any intergovernmental organization;

- Focusing on such a specific topic would be the best use of and consistent with ISAR's expertise in providing guidance on international best practices in reporting and disclosure; and

- Such guidance on implementation might be particularly useful for developing countries and for countries with economies in transition.

4. Once the Commission on Investment, Technology and Related Financial Issues approved the topic, an ad hoc consultative group consisting of experts from a wide cross-section of countries and organizations was formed. A list of the members of the consultative group of experts appears in Annex II. The group held consultations through electronic means and met in Geneva on 22–23 April 2002. This report contains the outcome of those consultations.

5. The objective of the informal consultations was to produce recommendations on corporate governance disclosures to help developing countries and countries with economies in transition apply generally accepted principles of corporate governance, given their particular economic, legal, social and cultural environments. The exercise starts with the main recommendations for disclosure relevant to corporate governance contained in such basic documents as the OECD Principles of Corporate Governance (OECD Principles), the Report of the Cadbury Committee on the Financial Aspects of Corporate Governance (Cadbury Report), the King Report on Corporate Governance for South Africa (King Report), the Commonwealth Association for Corporate Governance Guidelines (CACG Guidelines), pronouncements of the European Association of Securities Dealers (EASD) and the International Corporate Governance Network (ICGN), past ISAR Conclusions and others.

6. Reference is made in this report to the recommendations contained in the foregoing reports, since one objective is to illustrate the convergence of opinion on the content of corporate governance disclosures. Another objective of this report is to encourage countries and/or companies to develop their own codes tailored to their particular legal requirements and cultural traditions by giving examples of existing best practices.

7. During the informal consultations it was emphasized that ISAR's guidance on corporate governance disclosures would be a voluntary technical aid for regulators and companies in developing countries and countries with economies in transition as well as other countries and companies that may choose to use it. What organizations disclose and how they do it will depend considerably on local laws and customs. Therefore, the purpose of the work is to highlight the major concerns of international institutional and other investors and creditors and how they might be reassured by disclosures on corporate governance. This work would be relevant to enterprises eager to attract domestic as well as foreign investment regardless of their legal form or size. Such guidance would also promote awareness in countries and companies that are currently unwilling or unable to follow best practices and to satisfy investors' expectations regarding corporate governance disclosures, and which thus find it harder and probably more expensive to attract investment. In fact, some institutional investors have withdrawn from emerging markets where corporate governance is perceived to be weak.

8. After addressing the issue of the role of disclosures as part of sound corporate governance systems as outlined by major corporate governance codes and regulations, the informal consultative group considered the content of such disclosures, including financial disclosures, non-financial disclosures and disclosures in relation to annual general meetings. They also considered the timing and means of disclosures as well as disclosure of which code

of corporate governance is followed. The following sections present the main conclusions of the group on these issues.

I. FINANCIAL DISCLOSURES

9. High-quality financial disclosure is identified as one of the major requirements of sound corporate governance by almost all pronouncements on the subject. Sound financial reporting is also one of the principal responsibilities of the board of directors. It is specifically addressed by the Cadbury Report, OECD Principles, CACG Guidelines, the King Report and a number of country codes.

10. The ad hoc consultative group agreed that most of the generally accepted international recommendations on financial disclosures could be found in the International Financial Reporting Standards (IFRSs) promulgated by the International Accounting Standards Board (IASB). However, it saw reason to emphasize major areas specifically relevant to corporate governance concerning which additional explanations could be helpful to Governments, especially if their current accounting and reporting regulations or practices differed from those outlined in the IFRSs.

11. *In particular, the group stressed the importance of disclosure of the company's financial and operating results, related-party transactions and critical accounting policies.*[1]

12. *The group agreed that enterprises should disclose all the financial information necessary for shareholders and other stakeholders to properly understand the nature of their business and how it was being developed for the future. In particular, any accounting policies to which the published results of the enterprise are especially sensitive should be disclosed, and the impact of alternative accounting decisions discussed.* Information presented should include discussion of the effects of critical accounting policies applied, the judgments made in their application, and the likelihood of materially different reported results if different assumptions were to prevail. For example, a disclosure of the consolidation policies of an enterprise could include an assurance by the board of directors that they have ascertained that all subsidiaries and affiliated entities, including special-purpose ones, that are subject to consolidation as per the accounting and reporting standards applicable to the enterprise, have been properly consolidated. Disclosure requirements of this nature may discourage management from manipulating the accounting and reporting requirements and maintaining assets and liabilities off the enterprises' balance sheet and distorting fair presentation of its financial position and performance.

13. *The group recognized that enterprises should disclose all related-party transactions and in addition any related-party relationships where control exists. At a minimum, disclosure should be made of the nature, type and elements of the related-party transactions. Even related-party relationships where control exists, irrespective of whether there have been transactions with parties under common control, should be disclosed. The decision-making process for approving related-parties transactions should also be disclosed. Members of the*

[1] Non-italicized text is explanatory text; the italicized text represents recommendations of the consultative group made during its April meeting or during its virtual discussions which followed.

board and managers should disclose any material interests in transactions or other matters affecting the company.

14. The group recognized that the concept of materiality may differ from country to country. Therefore, some explanations of the principles or rules guiding the concept of materiality might be appropriate.

15. *Critical accounting policies that are key to the portrayal of an enterprise's financial condition and operating results should be disclosed.* The application of accounting policies involves management's assessment of matters that are inherently uncertain and the assessment of which can be subjective and complex. Therefore, a requirement to disclose these policies and outline the judgments made in their application, with mention of the fact that different assumptions might have resulted in materially different reported results, would help investors to better understand the strengths and weakness of the reported financial information. Furthermore, clearly identifying the inherent risks and the estimates used in the preparation of the reported information gives investors a better understanding of the risks they are taking in relying on the judgement of management.

16. For example, in some cases, accounting rules allow management to deviate from historical cost and present certain assets on a fair value basis. However, while for certain assets deep markets may exist and fair value can be obtained with reasonable objectivity, this may not be the case for others. Situations of the latter kind may invite management to exercise great latitude and influence the direction of earnings in its favour. For instance, in a recent case of financial fraud that brought down an enterprise, it is alleged that the management computed the fair value of certain assets on the basis of a highly inflated price that the company used for selling the product to one of its affiliates. The board of directors may provide additional assurance to shareholders and other stakeholders by disclosing that the board or its audit committee has reviewed fair value computations, if any, and that the computations were conducted in an objective manner and any intercompany transactions used as benchmarks in the process were of an arms-length nature.

II. NON-FINANCIAL DISCLOSURES

A. Company Objectives

17. *The ad hoc consultative group agreed that the objectives of the enterprise should be disclosed.* The objectives of enterprises may vary according to the values of society. In many, but by no means all, countries the primary corporate objective is to maximize the long-term return to shareholders (shareholder value). This objective appears in many codes throughout the world.

18. However, although there is an increasing awareness throughout the world that shareholder requirements must be met in order to attract and retain long-term, low-cost capital, the emphasis on shareholder value maximization is not universal. In the United Kingdom, proposed revisions of the Companies Act would include a statement of directors' duties which would emphasize that the primary duty of a director is to "promote the success

of the company for the benefit of its members as a whole". The King Report argues that the "directors must ... always strive to increase shareholder value while having regard for the interests of all other stakeholders" (Ch 5:27.7).

19. Overall, alongside the growing awareness of the requirements of shareholders, there is awareness of the need to address the interests of other stakeholders in order to maximize shareholder value in the long run. For example, if the enterprise knowingly damages a stakeholder's interest, it faces "reputation risk" that could affect shareholder value. The General Motors Board Guidelines acknowledged that "the board's responsibilities to shareholders as well as customers, employees, suppliers and the communities in which the corporation operates are all founded on the successful perpetuation of the business". This suggests that rather than pitting shareholder value against stakeholder value, an approach adopted by a large proportion of the academic community, there may be reason to believe that both sets of interests are compatible in the long run.

B. Ownership and Shareholders' Rights

20. *The ad hoc group recognized that the ownership structure should be fully disclosed to all shareholders. It was also recognized that changes in the shareholdings of substantial investors should be disclosed to the market as soon as a company became aware of them.* The ownership structure of an enterprise is of great importance in an investment decision, especially with regard to the equitable treatment of shareholders. In order to make an informed decision about the company, investors need access to information regarding its ownership structure.

21. In some countries disclosure is required when certain thresholds of ownership are passed. The German code for Corporate Governance states that as soon as the company becomes aware that another party has obtained, exceeds or no longer holds 5, 10, 25, 50 or 75 per cent of the voting rights in the company, this information must immediately be published (II.2.i).

22. *The group took a view that disclosure should be made of control structure and of how shareholders or other members of the organization can exercise their control rights through voting or other means. It also discussed that any arrangement under which some shareholders may have a degree of control disproportionate to their equity ownership, whether through differential voting rights, appointment of directors or other mechanisms, should be disclosed.*

23. In an extreme case, a company might have a single shareholder or group of shareholders with majority control of the company, either through holding the majority of the company's outstanding equity or through holding shares with superior voting rights. A majority shareholder group might be the management of the company and might gain more through a non-value-maximizing action than it would lose as a result of lost shareholder returns. In the case of such a conflict of interests, without safeguards for minority shareholders, the latter group may be adversely affected.

24. This issue is emphasized by a number of codes. For example, the OECD Principles suggest that disclosure should be made of major shareholders or others that control the company, including information on special voting rights, shareholder agreements, the ownership of controlling or large blocks of shares, significant cross-shareholding relationships and cross-guarantees. The Peters Report (Holland) recommends that "the Board of Directors should take stock of the influence available to investors in the company and report its findings in writing to them" (Recommendation 5.4.3).

25. A number of statements advocate a "one share one vote" principle at the international level. Examples, are found in the OECD's Principle I and in the International Corporate Governance Network.

26. However, actual practice might be different. For example, in the European Union, many member States do allow shares with multiple or no voting rights. This is seen as uncontroversial from an investor perspective as long as the differentials in voting rights are disclosed to all potential purchasers. The European Association of Stock Dealers does not support such deviations but allows flexibility, noting that if deviations cannot be avoided they should at least not apply in the same share class (EASD Principles, Recommendation II.2).

27. The strongest opposition to divergences from the one share, one vote principle is found in the Eurosharehoiders Guidelines (Guideline II). In contrast, the Hellebuyck Commission (France) viewed multiple voting rights as a way to reward the loyalty of certain shareholders (I.C.3) but felt that "it could be abused and used in a manner contrary to the spirit of reasonable governance."

28. *The group agreed that rules and procedures governing the acquisition of corporate control in the capital markets and extraordinary transactions such as mergers and sales of substantial portions of corporate assets should be disclosed.*

29. In most governance systems, it is generally considered good practice to set aside authority over certain issues for shareholder approval at a general meeting. Such issues include the power to amend the articles or other organic documents, approve new share issues, select auditors, elect directors, approve the accounts and distribution of dividends and approve extraordinary transactions such as mergers, acquisitions and takeovers.

C. Governance Structures and Policies

1. The structure, role and functions of the board

30. *The group took the view that the composition of the board should be disclosed, in particular the balance of executives and non-executive directors. Where there might be issues that stakeholders might perceive as challenging the independence of non-executive directors, companies should disclose why those issues are not significant and do not impinge on the independence of the directors.*

31. One of the main issues in relation to the board structure and its disclosure is the assurance that, whatever structure exists in the company it ensures the board's independent

leadership. Some countries would give more emphasis to the need for a clear division of responsibilities between the chairman and the chief executive officer (CEO) (Cadbury Report, para. 4.9) The later Combined Code in United Kingdom did support this view although it was slightly more ragmatic, acknowledging that some companies had successfully combined these roles.

32. However, there is no general agreement on this point. In France, Italy and Spain the general practice has been to combine the roles. In France this requirement has been enshrined in law. However, the Vienot II Report has suggested that the law be changed to allow corporations greater flexibility in choosing their preferred structure. Italy and Spain have accepted the view that measures are called for to balance the power at the head of the corporation but that separating the positions is not among the strategies to be considered.

33. If the roles of chairman and CEO are combined, the proportion of independent directors within the board structure assumes greater importance. For example, Cadbury recommended that where the roles were combined, there should be a strong independent element on the board and that there should be a lead non-executive director to whom issues regarding the executive management could be addressed. This idea is followed by both the Indian and Malaysian codes. However, the definition of an independent director varies in different countries, therefore, a reference to a particular approach used in defining director independence might be useful in disclosing and discussing the board structure.

34. *The group took the view that board's role and functions must be fully disclosed.* Most guidelines and codes of best practice emphasize the stewardship function of the board and distinguish its responsibilities from those of management. However, there are differences in the specificity with which the board's role is explained. For example, the Dey Report (Canada), the Vienot Report (France), Malaysia's Report on Corporate Governance, Mexico's Code of Corporate Governance, the King Report (South Africa) and the Korean Stock Exchange Code specify board functions as strategic planning, risk identification and management, selection, oversight and compensation of senior management, succession planning, communications with shareholders, integrity of financial controls and general legal compliance. However, others such as the Hong Kong Stock Exchange Code simply refer to directors' of ensuring compliance with listing rules. The degree of difference may reflect the degree to which company law or listing standards specify board responsibilities.

2. Board committees

35. The group noted that it was becoming a common practice for boards to establish board committees to share the workload, ensure efficient fulfilment of the board's functions and address some potential conflicts of interest.

36. *The ad hoc consultative group suggested that such governance structures be disclosed. In particular, the group agreed that the board should disclose structures put in place to prevent conflicts between the interests of the directors and management on the one side and those of shareholders and other stakeholders on the other.* These structures may include committees or groups to which the board has delegated responsibility for oversight of

executive remuneration, audit matters, appointments to the board, and the evaluation of management performance.

37. *It was also agreed that the composition and functions of any such groups or committees should be fully disclosed. Where any director has taken on a specific role for the board or within one of these structures, this should be disclosed.*

38. Internationally there has been consensus that although a board has collective responsibility, the use of committee delegating the responsibility for certain key board functions is advisable. This is especially true where executives may find themselves facing conflicts of interest – for example, in the areas of audits, remuneration and director nomination. As a general rule, codes have recommended that such committees be staffed by non-executive or outside directors, particularly independent directors. A number of codes address this issue, also outlining the need for clear terms of reference for such committees (Australia, South Africa, India, Malaysia).

D. Members of the Board and Key Executives

1. Duties and qualifications

39. *The group recommended that the duties of individual directors be disclosed. It was agreed that the number of directorships held by an individual director should be disclosed.*

40. The group discussed that if shareholders were to be confident that directors were performing in their interests, they needed to know what performance entailed, or, to put it more simply, what the duties of the directors were. Shareholders also need to be aware of the number of directorships that any individual director holds. Many codes are silent on this issue, including the Combined Code of the United Kingdom (although the National Association of Pension Funds has recently (May 2002) advocated that [non-executive] directors holding more than five posts be required to justify how they were able to do so, and that full-time executive directors should not take on more than one outside directorship).

41. The King Report states that executive directors should be encouraged by their companies to take non-executive appointments in other companies, provided the number of non-executive appointments does not adversely affect the director's executive responsibilities to his or her own company. The Dey Report advocates that the nominating committee assign a maximum figure, and the Malaysian Code also refers this area to the nominating committee. Meanwhile, the Indian Code advocates that no single director should hold directorships in more than 10 listed companies.

42. *The experts took the view that there should be sufficient disclosure of the qualifications and biographical information of all board members to assure shareholders and other stakeholders that the members can effectively fulfil their responsibilities. There should also be disclosure of the mechanisms which are in place to act as "checks and balances" on key individuals in the enterprise.*

43. Most governance guidelines and codes of best practice address topics related to directors' qualifications and board membership criteria. These may include experience, personal characteristics, core competencies, availability, diversity, age, skills such as the understanding of manufacturing technologies, international background, and so on. Some codes specifically require financial literacy (NACD) or knowledge of business and finance. (Brazilian Institute of Corporate Governance).

44. *There should be disclosure of the types of development and training that directors undergo at induction and on an ongoing basis (continuing education).*

45. Recently some countries have started to require specific training for directors. For example, Malaysia requires that directors attend courses designed to ensure that they are equipped to be competent directors.

Facility for professional advice

46. The group realized that on certain legal and financial matters, directors might discharge their duties more effectively if allowed access to an independent external source.

47. *Therefore, the group suggested that the board disclose facilities, which may exist to provide members with professional advice. The board should also disclose whether that facility has been used during the year in question.*

48. One important area where this procedure may be of use is with regard to nomination committees (Bosch, Guideline 4). The Merged Code in Belgium also points out the need for an agreed procedure for using such a facility, a point also mentioned in the Dey (Canada), Vienot (France), Mertanzis (Greece) and Olivencia (Spain) reports. Excessive use of outside advice may be a waste of shareholder funds and lead to questions about the efficacy of current management; on the other hand, if used correctly, such expertise may enhance the ability of directors to increase shareholder value.

2. Evaluation mechanism

49. *The ad hoc group agreed that the board should disclose whether it has a performance evaluation process in place, either for the board as a whole or for individual members. Disclosure should be made of how the board has evaluated its performance and how the results of the valuation are being used.* Along with the duties and responsibilities of directors, shareholders will need to know how directors were evaluated, what criteria were used and how they were applied in practice, particularly with reference to remuneration.

50. Common Wealth Association of Corporate Governance Guidelines stress that evaluations should be based on objective criteria including "the performance of the business, accomplishment of long-term strategic objectives and development of management". The *Preda Code (Italy) and IAIM Guidelines (Ireland) leave to the remuneration committee the* selection of appropriate criteria and the establishment of whether these criteria have been met.

51. An important aspect of performance is the attendance of directors at board meetings. In the "merit criteria" of the Kuala Lumpur Stock Exchange (KLSE), the first factor listed under the board of directors is "the frequency of board meetings and level of attendance by directors". Specific requirements regarding the frequency and procedures of board meetings can be found in the Indian Code, the King Report and the Combined Code of United Kingdom.

52. Evaluation procedures may also vary. Guidelines from Finland, Germany, the Netherlands and the United Kingdom stress that non-executive members of the board should meet without members of the management present in order to facilitate discussion of sensitive management issues. The Berlin Initiative Code specifies that evaluations should be conducted annually by the personnel committee and should deal with the board as a whole as well as with individual contributions.

3. Directors' remuneration

53. *The ad hoc consultative group took the view that directors should disclose a transparent and accountable mechanism for setting directors' remuneration. Disclosure should be as full as possible to demonstrate to shareholders and other stakeholders that pay is tied to the company's long-term performance as measured by recognized criteria. Information regarding pay packages should include salary, share options and other associated benefits, financial or otherwise, as well as reimbursed expenses. Where share options are used as incentives but are not treated as expenses in the accounts, their cost should be fully disclosed using a widely accepted pricing model.*

54. The current level of disclosure relating to directors' remuneration varies widely. In the United Kingdom the report of the company's remuneration committee must identify each director and specify his or her total compensation package, including share options. Recently added regulations also require companies to put their remuneration report to a shareholder vote at each annual general meeting. The Indian Code stipulates that a table containing details of each director's remuneration and commissions should form a part of the directors' report, in addition to the usual practice of having it as a note to the profit and loss statement. Switzerland is introducing new disclosure requirements for the publication of directors' salaries.

55. *The group discussed that the length of directors' contracts as well as the nature of compensation payable to any director for cancellation of service contract should be disclosed. Specific reference could be made to any special arrangement that might relate to severance payments to directors in the event of a takeover.*

4. Succession planning

56. *The group took the view that the board should disclose whether it has established a succession plan for key executives and other board members to ensure that there is a strategy for sustaining the business. It also recognized that there might be confidentiality issues and that the details of any individual plan should not necessarily be publicly disclosed.*

57. While current performance is of utmost importance, it is also imperative that performance not be allowed to suffer because of board members resignations or retirements. It is important to ensure board continuity and smooth transitions.

58. OECD Principle V.D.2 stresses that overseeing succession planning is a key function of the board, while the Dey Report (Canada) considers it an important stewardship duty of the company. Vienot Report I (France) recommended that "it should be the permanent responsibility of the selection committee to be in a position to propose successors at short notice", although clearly this would require confidentiality.

5. Conflict of interest

59. *The group suggested that conflicts of interests affecting members of the board should, if they were not avoidable, at least be disclosed. The board of directors should disclose whether it has a formal procedure for addressing such situations, as well as the hierarchy of obligations to which directors are subject.*

E. Material Issues Regarding Employees and Other Stakeholders

60. *The group recommended disclosure of whether there was a mechanism protecting the rights of other stakeholders in a business.*

61. OECD Principle III concerns itself with ensuring that the rights of stakeholders protected by law are respected. Even where no legislation exists, it is considered good practice to make additional commitments, as corporate reputation and performance may require recognition of broader interests. For example, revisions to the Company Law in the United Kingdom are expected to include requirements that boards disclose the impacts of their decisions on communities, employees and suppliers. The CACG Guidelines require that a board identify the corporation's internal and external stakeholders and agree on a policy for how the corporation should relate to them.

62. The most contentious stakeholder issue, however, is most likely the role of employees in corporate governance. For example, in the European Union various practices exist where employees elect some of the supervisory directors, can be given a right to nominate one or more directors or can have an advisory voice on certain issues discussed by the board. This allows stakeholders a role in the governance process without diluting the property rights of shareholders. Employee stock ownership plans and other employee stock ownership vehicles can permit employees and/or their representatives in trade unions and on work councils greater involvement in corporate governance as shareholders. The latter issue is particularly controversial and should be subject to additional disclosure.

F. Environmental and Social Stewardship

63. *The group took the view that the board should disclose its policy and performance in connection with environmental and social responsibility and the impact of this policy and performance on the firm's sustainability.* The issue was addressed earlier by ISAR in its agreed conclusions on Accounting and Financial Reporting for Environmental Costs and

Liabilities. ISAR noted that an enterprise's environmental performance could affect its financial wealth and hence its sustainability. Its surveys found that environmental disclosures were qualitative, descriptive, partial and difficult to compare. Taking into consideration best practices, the ISAR guidance helps enterprises to understand which environmental transactions and events need to be reported in financial statements and associated notes.

64. The Global Compact and the Global Reporting Initiative encourage both environmental and social responsibility and disclosure thereof. These are also specifically addressed by the King Report (South Africa), by the Association of British Insurers in its Disclosure Guidelines on Socially Responsible Investment and by others.

65. Growing interest in social responsibility rankings and indices has brought direct pressure on corporations to conduct responsible stakeholder relations. In the United Kingdom, the Association of British Insurers has announced that it expects boards to assess risks and opportunities in social, environmental and ethical matters and that it considers these issues to be intertwined with corporate success. United Kingdom regulations have required investment fund companies to disclose whether they have policies on social investment, and the new Company Law is expected to include requirements that boards disclose the impacts of their decisions on communities, employees and suppliers. Australia, Belgium, France, Germany and Sweden have also introduced legislation on socially responsible investment.

G. Material Foreseeable Risk Factors

66. In recent years, much attention has been paid to the role of the board in risk assessment or management and internal controls. Therefore, the ad hoc consultative group addressed the issue of risk management disclosures.

67. *The group took the view that the board should give appropriate disclosures and assurance regarding its risk management objectives, systems and activities. In particular, it was agreed that the board should disclose existing provisions for mitigating the possible negative effects of risk-bearing activities. The board should report on internal control systems and their effectiveness.*

68. This issue is emphasized in most for codes and principles. The OECD Principles point out that users of financial information and participants in the marketplace need information on foreseeable material risks, including risks specific to industries or geographical areas, dependence on certain commodities, financial market risk and derivative risks. However, such disclosure is only considered to be effective when it is tailored to the individual industry or company. The issue is also addressed in detail by the CACG Guidelines, the King Report, the Combined Code, the Cadbury Report and the Turnbull Report in the United Kingdom.

H. Independence of Auditors

69. *The group agreed that the board should disclose that it had confidence that the auditors are independent and their integrity had not been compromised in any way. The process for interaction with and appointment of internal and external auditors should be disclosed.*

70. OECD Principle IV.C states that independent external audits should provide an objective assurance of the way in which the accounts have been prepared. The issue is also addressed by the Cadbury Report, the Blue Ribbon Committee Report on Improving the Effectiveness of Corporate Audit Committees (United States), the Merged Code (Belgium), the Dey Report (Canada) and the Preda Report (Italy), which also discusses communication between the audit committee and external auditors.

71. A number of issues regarding the external audits such as the need for auditor rotation and possible conflicts of interest involved in providing non-audit services, are being debated to ensure that external audits serve public interests in the intended manner. Therefore, disclosure in these areas may provide stakeholders and potential investors with useful information. Disclosure may include the selection and approval process for external auditors, the length of the relationship (e.g. whether the same audit firm has been engaged for more than five years and whether there has been a rotation of audit partners), who governs the relationship with the auditor, whether auditors do any non-audit work and what percentage of the total fees paid to the auditor involves non-audit work.

III. ANNUAL GENERAL MEETINGS

72. *The group discussed the need for disclosure of the process for holding annual general meetings. Notification of the agenda should be made in a timely fashion, and the agenda should be made available in the national language (or one of the official languages) of the enterprise and, if appropriate, an internationally used business language.*

73. The OECD Principles outline a general consensus as to the nature of shareholder meetings and the requirement to make shareholder participation as simple and effective as possible and ensure the equitable treatment of all shareholders. The Principles state that shareholders should be able to participate effectively and vote in the general meetings of the company. They should be informed of the rules and, to this end, be furnished with information regarding the date, location and agenda of the meeting as well as the issues to be decided.

74. In most governance systems, it is generally considered good practice to put several issues to shareholder approval at a general meeting. These rules may vary in different countries, and therefore information on the subject would be useful for investors. This area deserves more attention.

IV. TIMING AND MEANS OF DISCLOSURE

75. The group agreed that all material issues relating to corporate governance of the enterprise should be disclosed in a timely fashion. The disclosure should be clear, concise, precise and governed by the "substance over form" principle. Some issues may require continuous disclosure. Relevant information should be available for users in a cost-effective way.

76. The location of corporate governance disclosures within the annual report is not generally defined: some disclosures are in the notes to the accounts, others in the directors'

report, still others in a separate report of the remuneration committee or the audit committee or in a separate corporate governance report. Some degree of harmonization of the location of corporate governance disclosures would be desirable to enable users of financial statements to access the relevant data more readily. Possible approaches include putting all disclosures on corporate governance in a separate section of the annual report or providing a stand-alone corporate governance report.

77. Some information related to corporate governance may require immediate disclosure, and some codes address this issue. In some cases, the requirements are contained in listing requirements. For example, in Malaysia listing requirements call for immediate disclosure of a number of transactions including acquisition or loss of a contract; a change in the management, external auditor or board structure; the borrowing of funds; commencement of or involvement in litigation and any material development arising therefrom; the commencement of arbitration proceedings or proceedings involving alternative dispute resolution methods; and a number of other types of events.

78. It is widely recognized that traditional channels of communication with stakeholders, such as annual reports, should be supported by other channels of communication taking into account the complexity and globalization of financial markets and the impact of technology. The OECD Principles state that the Internet and other information technologies provide the opportunity for improving information dissemination.

79. The King Report, which also emphasizes the need for critical financial information to reach all shareholders simultaneously, supports this. It also states that, considering costs involved in printing and distributing annual financial statements to all shareholders, consideration should be given to the electronic distribution of a summarized or abbreviated annual financial statement to all shareholders, with a clear indication of how the complete annual financial statements can be obtained.

80. Whatever disclosures are made and whatever channels used, a clear distinction should be made between audited and unaudited financial information, and means of validation of other non-financial information should be provided.

V. BEST PRACTICES FOR COMPLIANCE WITH CORPORATE GOVERNANCE

81. The ad-hoc consultative group recognized that, where there was a local code on corporate Governance, enterprises should be encouraged to disclose the extent to which they followed its recommendations and to explain any failures to follow recommendations. Where there is no local code on corporate governance, companies should be encouraged to follow best international practices. The use of "comply or explain" mechanisms in many countries allows investors greater access to information about the corporation and is to be encouraged.

VI. CONCLUSIONS

82. This report has considered a range of areas in which disclosure may be advantageous to users of corporate information. It has discussed disclosure relating to financial and non-

VI. CONCLUSIONS

82. This report has considered a range of areas in which disclosure may be advantageous to users of corporate information. It has discussed disclosure relating to financial and non-financial information, the objectives of the company, ownership structure and control devices, board composition and functions, environmental and social responsibility and risk management. It has examined disclosure on the annual meeting and the protection of shareholder and stakeholder rights. Finally, it has looked at the timing and means of disclosure and disclosure on the adoption of best practices in compliance with corporate governance requirements.

83. In looking at areas where disclosure is necessary, the report has given examples from best practice codes from a number of countries. Although the review of such regional and national codes is by no means exhaustive, an attempt has been made to present a balanced review.

84. One of the central tasks of the 19th session of ISAR is to evaluate this report and the conclusions of the ad hoc consultative group. If the 19th session finds these conclusions useful, it could discuss the elaboration of further guidance embodying both the generally accepted best practices outlined here as well as ways and means of implementing these practices and producing a guideline for national standard setters on corporate governance disclosures.

Annex I

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Annex II

Members of the Ad Hoc Consultative Group of Experts on Corporate Governance Disclosures[2]

Mr. André Baladi
Co-Founder, ICGN
SWITZERLAND

Ms. Amra Balic
Standard & Poors
UNITED KINGDOM

Mr. M. Baree
The Institute of Chartered Accountants of Bangladesh
BANGLADESH

Ms. Heloisa Bedicks
Instituto Brasileiro de Governança Corporativa
BRAZIL

Mr. Robert Blanks
Institute of Chartered Secretaries & Administrators
UNITED KINGDOM

Mr. Geoffrey Bowes
Chief Executive
Commonwealth Association of Corporate Governance
NEW ZEALAND

Mr. Istvan Friedrich
International Business School
HUNGARY

Mr. Ndung'u Gathinji
Eastern Central & Southern African Federation of Accountants
KENYA

Mrs. Vicki Harris
Department for International Development
UNITED KINGDOM

Mr. Mark Hawkins
Ernst & Young
SWITZERLAND

Mr. Karugor Katamah
Private Sector Corporate Governance Trust
KENYA

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[2] Opinions expressed by the experts do not necessarily reflect those of the organizations they are affiliated with.

Mr. George Kyriakides
Audit Office of the Republic of Cyprus
CYPRUS

Mr. Jeremy Leach
Department for International Development
UNITED KINGDOM

Mr. Paul Lee
Hermes Investment Management Limited
UNITED KINGDOM

Prof. Christine Mallin (resource person)
University of Birmingham
UNITED KINGDOM

Mr. Abbas Mirza (resource person)
Deloitte & Touche
UNITED ARAB EMIRATES

Mr. Serge Montangero
Deloitte & Touche
SWITZERLAND

Mr. Paul Moxey
The Association of Chartered Certified Accountants
UNITED KINGDOM

Ms. Mary Ncube
M. T. Ncube and Associates
ZAMBIA

Mr. Mustafizur Rahman
The Institute of Chartered Accountants of Bangladesh
BANGLADESH

Mr. Tony Renton
Institute of Directors
UNITED KINGDOM

Mr. John Rieger
Organization for Economic Co-operation and Development
FRANCE

Mr. Dominique Thienpont
European Commission
BELGIUM

Mr. Anthony Travis
PricewaterhouseCoopers
SWITZERLAND